

---

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

---

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 30, 2006

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to  
Commission file number 0-21196

---

**Mothers Work, Inc.**

(Exact name of Registrant as specified in its charter)

<b>Delaware</b> (State or other jurisdiction of incorporation or organization) <b>456 North Fifth Street,</b> <b>Philadelphia, PA</b> (Address of principal executive offices)	<b>13-3045573</b> (IRS Employer Identification No.)  <b>19123</b> (Zip Code)
---	---

**(215) 873-2200**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

**Series B Junior Participating Preferred Stock Purchase Rights**  
(Title of class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed using \$24.02, the price at which the common equity was last sold as of March 31, 2006 (the last business day of the Registrant's most recently completed second fiscal quarter), was approximately \$112,000,000.

On December 11, 2006, there were 5,888,374 shares of the Registrant's common stock, \$0.01 par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement to be filed with the Commission in connection with the Annual Meeting of Stockholders scheduled to be held on January 19, 2007 are incorporated by reference into Part III of this Form 10-K.

---

---

## PART I.

*Our fiscal year ends on September 30. All references in this report to our fiscal years refer to the fiscal year ended on September 30 in the year mentioned. For example, our "fiscal 2006" ended on September 30, 2006. Unless otherwise indicated, operating data referred to in this report is as of September 30, 2006. As used in this report, "retail locations" include our stores and leased departments and exclude locations where Kohl's® sells our products under an exclusive product and license agreement.*

### Item 1. Business

#### Overview

We are the leading designer and retailer of maternity apparel in the United States and are the only nationwide chain of maternity specialty stores. We operate 1,541 retail locations, including 810 stores in all 50 states, Puerto Rico and Canada, and 731 leased departments located within department stores and baby specialty stores throughout the U.S. We are also the exclusive provider of maternity apparel to Kohl's®, which operates approximately 749 stores throughout the U.S. We operate our 810 stores under four retail nameplates: Motherhood Maternity®, Mimi Maternity®, A Pea in the Pod® and Destination Maternity™. In addition to our 810 stores, we operate 731 maternity apparel departments, which we refer to as leased departments, within leading retailers such as Sears®, Macy's® and Babies "R" Us®. We are the exclusive maternity apparel provider in each of our leased department relationships. We also sell merchandise on the Internet, primarily through DestinationMaternity.com and our various chain specific websites. We have achieved 9.2% compounded annual sales growth over the past five years, resulting in sales of \$602.7 million for fiscal 2006.

We have a leading position across all major price points of maternity apparel through our five distinct merchandise brands, enabling us to reach a broad range of maternity customers. Through our 810 stores and certain of our leased departments, we offer maternity apparel under our three primary merchandise brands, Motherhood Maternity, or Motherhood, at value prices, Mimi Maternity, or Mimi, at contemporary prices and A Pea in the Pod, or Pea, at luxury prices. We also have two additional value-priced maternity apparel brands, our Two Hearts® Maternity collection and our Oh Baby! by Motherhood™ collection which we sell exclusively through Sears and Kohl's, respectively, and are the exclusive maternity apparel offerings in these chains.

We believe that one of our key competitive advantages is our ability to fulfill, in a high-service store environment, all of an expectant and nursing mother's clothing needs, including casual and career wear, formal attire, lingerie, sportswear and outerwear, in sizes that cover all trimesters of the maternity cycle. Our sophisticated vertically-integrated business model enables us to offer the broadest assortment of in-stock, fashionable maternity apparel. We design and contract for the production of approximately 90% of the merchandise we sell using sewing factories located throughout the world, predominantly outside of the U.S.

In fiscal 2003, we began to develop and introduce, on a limited basis, new multi-brand store concepts that offer merchandise from our Motherhood brand, Mimi brand and, sometimes, our Pea brand, in order to provide a broader product assortment at multiple price ranges to our customers and to increase average store sales and profitability. We continue to test, develop and expand our new multi-brand store concepts, which consist of two-brand Mimi nameplate "combo" stores, three-brand Mimi nameplate "triplex" stores, and Destination Maternity superstores, which generally carry all three of our principal merchandise brands as well as a significant array of maternity-related products and customer service features. These multi-brand stores are larger and have higher average sales than our average store, provide the opportunity to improve store operating profit margins over time by reducing store operating expense percentages through economies of scale, and may increase overall sales in the geographical markets they serve.

Opening these multi-brand stores will typically involve closing two or more smaller stores and may frequently result in one-time store closing costs resulting primarily from early lease terminations.

We plan to open approximately 15 - 20 new retail stores during fiscal 2007, of which we expect approximately 7 - 12 will be new multi-brand stores that carry more than one of our merchandise brands, with the balance primarily under the Motherhood brand. We estimate that we will close approximately 40 - 55 stores in fiscal 2007, with approximately 15 - 25 of these store closings related to the opening of new multi-brand stores.

We believe our customers, particularly first-time mothers, are entering a new life stage that drives widespread changes in purchasing needs and behavior, thus making our maternity customer and her family a highly-valued demographic for a range of consumer products and services companies. As a result, we have been able to expand and leverage the relationship we have with our customers and generate incremental revenues and earnings by offering other value-added baby and parent-related products and services through a variety of marketing partnership programs utilizing our extensive opt-in customer database and various in-store marketing initiatives.

Mothers Work was founded by Dan and Rebecca Matthias in 1982 as a mail-order maternity apparel catalog. We began operating retail stores in 1985 and completed our initial public offering in 1993. To address multiple price points in maternity apparel and improve operating productivity, we acquired Motherhood and A Pea in the Pod in 1995 and eSpecialty Brands, LLC, or iMaternity, in October 2001. Since the acquisitions of Motherhood and A Pea in the Pod, we have developed and grown these brands along with growing our Mimi brand. Also, since the 1990s we have partnered with other retailers to sell our products through maternity apparel departments within their stores. Since the beginning of fiscal 2005, we have significantly expanded this third-party distribution channel by becoming the exclusive maternity apparel provider to Sears and Kohl's.

#### **Industry Overview**

We are unaware of any reliable data on the size of the maternity apparel industry. However, based on our own analysis, we believe that there are approximately \$1.2 billion of maternity clothes sold each year in the U.S. In addition, we believe that there is an opportunity to grow the business by selling maternity clothes to pregnant women who currently purchase loose-fitting or larger-sized non-maternity clothing as a substitute for maternity wear. We also believe that the business can grow by reducing the amount of "hand-me-down" and "borrowing" associated with maternity apparel, particularly in the value-priced segment where low-priced, fashionable maternity apparel could provide an economical alternative to secondhand maternity wear. Further, we believe that the demand for maternity apparel is relatively stable when compared to non-maternity apparel. Expectant mothers continue to need to replace their clothes and the current steady rate of approximately four million U.S. births per year has remained stable over the last decade. We believe that maternity apparel is also less fashion sensitive than specialty apparel in general, as demand is driven primarily by the need to replace wardrobe basics as opposed to current fashion trends.

#### **Our Competitive Strengths**

*We are the leader in maternity apparel.* We are the leading designer and retailer of maternity apparel in the U.S. and are the only nationwide chain of maternity specialty stores. We believe that our brands are the most recognized in maternity apparel. We have established a broad distribution network, with stores in a wide range of geographic areas and retailing venues. In addition, we have a leading position across all major price points of maternity apparel through our four retail store nameplates and our five merchandise brands. Our exclusive focus on maternity apparel and our leadership position enable us to gain a comprehensive understanding of the needs of our maternity customers and keep abreast of fashion and

product developments. We further enhance our leadership position, increase market penetration and build our brands by distributing our products under exclusive leased department and licensed relationships.

***We offer a comprehensive assortment of maternity apparel and accessories.*** A primary consideration for expectant mothers shopping for maternity clothes is product assortment, as pregnant women need to replace almost their entire wardrobe. We believe that we offer the widest selection of merchandise in the maternity apparel industry. We also offer product for multiple seasons, as pregnant women's clothing needs vary depending on their due date. Our ability to offer a broad assortment of product is due, in large part, to our vertically integrated business model, which includes our extensive in-house design and contract manufacturing capabilities, as well as our rapid inventory replenishment system.

***We are vertically integrated.*** We design and contract manufacture approximately 90% of the merchandise we sell. We believe that vertical integration enables us to offer the broadest assortment of maternity apparel, to respond quickly to fashion trends and to maximize in-stock levels. We combine our in-house design expertise, domestic and international sourcing capabilities, a rapid inventory replenishment process and extensive proprietary systems to enhance operational and financial results.

***We utilize a rapid inventory replenishment system.*** We are able to offer a wide selection of merchandise in our retail locations due, in large part, to our rapid inventory replenishment system. For example, in our stores, our proprietary system enables us to offer more than 3,000 stock keeping units, or SKUs, per store without dedicating retail space to "back-stock" storage. We coordinate the rapid replenishment of inventory for all of our retail locations through our Philadelphia, Pennsylvania and Mississauga, Ontario distribution centers to meet the individualized needs of our retail locations, which receive shipments from our distribution centers between two and six times per week. This enables us to maintain a high percentage in-stock merchandise position in each of our retail locations.

***We have proprietary systems that support our business.*** In order to support our vertically integrated business model and inventory replenishment system, we have developed a fully integrated, proprietary enterprise resource planning (ERP) system. This system includes point-of-sale systems, our TrendTrack™ merchandise analysis and planning system, our materials requirement planning system and our web-based, global sourcing and logistics systems. These systems also support our automated picking and sorting systems and other aspects of our logistics infrastructure. We believe that our proprietary systems are a critical competitive strength that enables us to offer a broad product assortment and respond quickly to fashion trends as well as helps us to reduce product costs and rapidly replenish inventory in our retail locations.

***We are able to obtain prime real estate locations.*** We believe our ability to lease attractive real estate locations is enhanced due to the brand awareness of our concepts, our multiple price point approach, our highly sought after maternity customer and our dedicated in-house real estate management and procurement team. We are the only maternity apparel retailer to provide mall operators with the ability to choose from three differently priced concepts, depending on the mall's target demographics. We are also able to provide multiple stores or a multi-brand store for malls that want to offer their maternity customers a range of price alternatives. In addition, in the case of multi-mall operators, we have the flexibility to provide several stores across multiple malls. As a result, we have been able to locate stores in many of what we believe are the most desirable shopping malls in the country and are able to obtain attractive locations within these malls.

***We are able to enhance our leadership position by distributing our products under exclusive leased department and licensed relationships.*** We operate 731 leased departments within leading retailers such as Sears, Macy's and Babies "R" Us. We are also the exclusive provider of maternity apparel to Kohl's pursuant to an exclusive licensed relationship. Over the past several years, we have increased the sales we generate from our leased department and licensed relationships and believe that we have an opportunity to



continue to increase the sales we generate from these relationships through expanding our relationships with our current partners as well as developing relationships with new partners.

**We have a highly experienced management team.** Dan Matthias, our Chairman and Chief Executive Officer, and Rebecca Matthias, our President and Chief Operating Officer, founded the Company over 20 years ago and are leaders in maternity apparel retailing. Additionally, we have a management team with significant experience in all aspects of the retail and apparel business.

#### Merchandise Brands

We believe that our brands are the most recognized brands in the maternity apparel business. We sell our merchandise under the following five distinct brands:

BRAND	BRAND POSITIONING	APPAREL PRICE RANGE
Motherhood	Broad assortment, fashion, quality and everyday low price	\$9-\$49
Mimi	Contemporary, fun, trendy and affordable	\$18-\$168
Pea	Exclusive, designer and luxury	\$60-\$395
Two Hearts Maternity	Select assortment of quality fashion sold at value price points	\$9-\$44
Oh Baby! by Motherhood	Select assortment of basics and fashion sold at value price points	\$9-\$48*

\*Kohl's, which sells our Oh Baby! by Motherhood brand under an exclusive product and license agreement, sets the apparel price range for this merchandise.

**Motherhood Maternity.** Our Motherhood Maternity brand serves the value-priced portion of the maternity apparel industry, which has the greatest number of customers. The Motherhood brand is positioned with a broad assortment of quality fashion at everyday low prices. We believe that the Motherhood customer shops at moderate-priced department stores and discount stores when she is not expecting.

**Mimi Maternity.** Our Mimi Maternity brand serves the medium-priced portion of the maternity apparel industry. The Mimi brand is positioned as trendy, contemporary, fun and affordable. We believe that the Mimi customer shops at department stores and specialty apparel chains when she is not expecting.

**A Pea in the Pod.** We believe our A Pea in the Pod brand is the leading luxury maternity brand in the U.S. The Pea brand is positioned as exclusive, designer and luxury. Publicity, including celebrities wearing our clothes, is an important part of the marketing and positioning of the brand.

**Two Hearts Maternity.** Our Two Hearts Maternity brand is the exclusive maternity apparel offering in 549 Sears stores that offer maternity apparel. Two Hearts Maternity is a new fashionable collection including career and casual sportswear as well as dresses, lingerie, swimwear and nursing sleepwear, with most items priced under \$40.

**Oh Baby! by Motherhood.** Our Oh Baby! by Motherhood collection was launched in February 2005 at Kohl's stores throughout the U.S. and on Kohls.com. The Oh Baby! by Motherhood collection is available at all Kohl's stores under an exclusive product and license agreement. The collection features a modern and complete assortment of sportswear, intimate apparel and sleepwear, with most items priced under \$40. The collection is available at all of Kohl's stores.

**Retail Nameplates**

We sell maternity apparel through the following stores, leased departments and licensed relationships:

Store Nameplate	Description of Target Location	Brand(s) Carried	Apparel Price Range	Average Size (Sq. Ft.)
<b>Stores:</b>				
Motherhood	Moderate regional malls, strip centers and power centers	Motherhood	\$9-\$49	1,700
Mimi (1)	Mid-priced regional malls and lifestyle centers	Motherhood Mimi	Single brand Mimi \$18-\$168 Mimi combo \$9-\$168	Single brand Mimi 1,700 Mimi combo 2,700
Pea (2)	Exclusive, high-end regional malls and affluent residential areas	Pea Mimi Designer Merchandise	\$60-\$395	2,300
Destination Maternity (3)	Primarily outdoor and power centers and central business districts	Motherhood Mimi Pea	\$9-\$395	6,900
<b>Leased Departments:</b>				
Macy's	Mid-priced regional malls	Motherhood Mimi	\$9-\$168	—
Babies "R" Us	Big box power centers	Motherhood	\$9-\$49	—
Sears	Moderate malls	Two Hearts Maternity	\$9-\$44	—
<b>Exclusive Licensed Relationship:</b>				
Kohl's	Big box power centers	Oh Baby! by Motherhood	\$9-\$48 (4)	—

(1)Our two-brand Mimi combo stores carry a full line of both Mimi and Motherhood brand merchandise while our triplex stores carry all three brands

(2)Nearly all Pea stores carry a full line of both Pea and Mimi brand merchandise.

(3)While most Destination Maternity stores carry Pea brand merchandise, some do not.

(4)Kohl's, which sells our Oh Baby! by Motherhood brand under an exclusive product and license agreement, sets the apparel price range for this merchandise.

Major regional malls with several department stores and a wide range of price points may be able to accommodate a multi-brand store, or more than one maternity store. We have the ability to address multiple price alternatives at a given mall, with Motherhood as our value-oriented brand, Mimi as our mid-priced brand and A Pea in the Pod as our luxury brand. As of September 30, 2006, we had at least two of our store concepts in 41 major regional malls. In addition, almost all 33 of our A Pea in the Pod stores

and 11 of our Motherhood stores carry Mimi-branded merchandise, and 36 of our Mimi stores carry Motherhood-branded merchandise.

**Motherhood Maternity Stores.** Motherhood Maternity is our largest chain with 659 stores as of September 30, 2006. Motherhood is positioned with a broad assortment of quality fashion at everyday low prices. Motherhood stores average approximately 1,700 square feet and are located primarily in moderate regional enclosed malls, strip and power centers and central business districts. Motherhood stores include 97 outlet locations that carry Motherhood-branded merchandise as well as some closeout merchandise. Between 1998 and 2000, we successfully broadened Motherhood's customer base by lowering price points approximately 40% to 45%. This reduced price position significantly expanded the brand's target market, increased revenues per store and increased unit volumes. In fiscal 2006, we opened 13 new Motherhood stores and outlets, including one store as a result of a store conversion from Mimi to Motherhood, and closed 44 Motherhood stores and outlets, with nine of these store closings related to multi-brand store openings. As of September 30, 2006, we operate 34 Motherhood stores in Canada and believe that market opportunities may permit us to open additional stores in Canada in the future. We may also have the opportunity to grow the number of our Motherhood leased departments in the U.S.

**Mimi Maternity Stores.** As of September 30, 2006, we had 106 Mimi Maternity stores that serve the medium-priced portion of the maternity apparel industry. The brand is positioned as contemporary, fun, trendy and affordable. Mimi stores average approximately 2,000 square feet and are located primarily in mid-priced regional malls, lifestyle centers and central business districts.

*Single-Brand Mimi Stores.* As of September 30, 2006, 70 of our Mimi stores predominantly carry Mimi-branded product, as well as a small selection of maternity merchandise developed by contemporary vendors for Mimi, and average approximately 1,700 square feet. Mimi was historically price positioned just below A Pea in the Pod. When Motherhood's prices were lowered, there was an opportunity for Mimi to broaden its customer base by including lower price points. Mimi was, therefore, repositioned during fiscal 2002 and its merchandise price points now range from just above Motherhood to the lower end of A Pea in the Pod. This repositioning resulted in an expansion of Mimi's target customer base, and provided us the opportunity to increase the number of Mimi stores over time.

*Mimi Combo Stores.* We are continuing to test, develop and expand our Mimi combo multi-brand store concepts. Our current Mimi combo store concepts operated under the Mimi name include two-brand stores (which carry both the Mimi and Motherhood brands) and triplex stores (which carry the Mimi, Motherhood and A Pea in the Pod brands). These Mimi combo stores are larger (average of approximately 2,700 square feet), have higher average sales volume than our average store and provide the opportunity to improve store operating profit margins over time. A new Mimi combo store will typically involve closing one Motherhood store and one single-brand Mimi store, although we may occasionally close only one store in a given geographical market in situations where we believe we can expand sales through replacing a single-brand Motherhood or Mimi store with a Mimi combo store. Store closings will often involve one-time store closing costs resulting primarily from early lease terminations. As of September 30, 2006, 36 of our stores are Mimi combo stores using the Mimi name, consisting of 34 two-brand Mimi stores and two Mimi triplex stores. Based on our internal research, we believe that over the next several years we have the potential to expand the Mimi combo store chain to approximately 70 to 80 or more total Mimi combo stores in the U.S.

In fiscal 2006, we opened one single-brand Mimi Maternity store and closed 12 Mimi stores, including two multi-brand Mimi stores. One of the multi-brand Mimi closings was as a result of a store conversion from Mimi to Motherhood.

**A Pea in the Pod Stores.** As of September 30, 2006, we had 33 A Pea in the Pod stores. A Pea in the Pod stores average approximately 2,300 square feet and are located in upscale venues, including Madison Avenue, Oak Street, Beverly Hills, South Coast Plaza and Bal Harbour. In addition to offering a wide selection of both A Pea in the Pod and Mimi branded products in almost all A Pea in the Pod stores, we seek out designer and contemporary brands and assist them in developing maternity versions of select styles exclusively for our A Pea in the Pod stores. As scarcity is part of the concept's luxury image, we have chosen to further develop the brand primarily by optimizing our customers' in-store experience rather than by opening new stores. We therefore continuously upgrade the quality of the locations, our store designs, the product styling and our publicity to enhance our brand image.

**Destination Maternity Superstores.** In March 2004, we opened our first Destination Maternity superstore in Danbury, Connecticut. Destination Maternity superstores typically carry all three of our primary merchandise brands (Motherhood, Mimi and Pea), plus a greatly expanded line of nursing accessories, fertility-related products and maternity-related exercise gear, books, and body and nutritional products. These stores also typically feature a dedicated "learning center" area for maternity-related classes, a "relax area" for husbands and shoppers alike, and an inside play area for the pregnant mom's toddlers and young children, with several of our superstores also having our Edamame The Maternity Spa®. These elements combine to give our Destination Maternity superstore not only the largest assortment of maternity apparel and accessories available, but also a unique and engaging atmosphere and experience for the maternity customer. A new Destination Maternity superstore involves closing at least two, and typically more, single brand stores, is expected to decrease store operating expense percentages through economies of scale, and may increase overall sales in the geographical areas they serve. Destination Maternity superstores range from nearly 4,000 square feet to approximately 11,000 square feet, with an average of approximately 6,900 square feet for the 12 stores open as of September 30, 2006. We opened four of these Destination Maternity superstores during fiscal 2006. In February 2006, we celebrated the grand opening of our Destination Maternity store on the corner of 57th Street and Madison Avenue in Manhattan. This is the largest maternity store in the world, spanning three floors and including our Edamame The Maternity Spa, all three of our primary apparel brands, maternity yoga classes, juice bar, relax area and children's play area. As the only national retailer that is solely focused on maternity, we are further differentiating ourselves as the ultimate maternity destination with these large, well-assorted, "must visit" superstores. Based on our internal research, we believe that over the next several years we have the potential to expand the Destination Maternity chain to approximately 40 to 50 or more total Destination Maternity superstores in the U.S.

**Leased Departments.** In addition to the stores we operate, we have arrangements with department stores and baby specialty stores, including Sears, Macy's, Babies "R" Us and Bloomingdale's®, to operate maternity apparel departments in their stores. We recently entered into arrangements for exclusive leased department relationships with Boscov's® and Gordmans®, two regional department store chains. We are the exclusive maternity apparel provider in each of our leased department locations. We staff these leased departments at varying levels and maintain control of the pricing terms and the timing and degree of the mark downs of our merchandise that is sold in the leased departments. We operate our leased departments during the same hours and days as the host store and are responsible for replenishment of the merchandise in the leased departments. These leased departments typically involve the lease partner collecting all of the revenue from the leased department. The revenue is remitted to us, less a fixed percentage of the volume earned by the lease partner as stipulated in the agreement.

**Exclusive Licensed Relationship.** Our Oh Baby! by Motherhood collection is available at all Kohl's stores under an exclusive product and license agreement. The collection was launched in February 2005 at Kohl's stores throughout the U.S. and on Kohls.com. Kohl's operates approximately 749 stores throughout the U.S.

**International.** We believe that in the future, an opportunity for sales growth may come from the development of international sales outside of North America. Currently, our only product sales outside of the U.S. are generated in Canada, where we operate 34 Motherhood stores. We anticipate that our long-term strategy may include both licensing arrangements with foreign partners as well as potentially developing our own operations in certain countries. However, we presently have no commitment, agreement or plans relating to any product distribution or development of selling operations outside of North America.

#### **Internet Operations**

We sell our merchandise on the Internet at our DestinationMaternity.com, MaternityMall.com and iMaternity.com websites, as well as our chain-specific websites such as Motherhood.com. We believe that many pregnant women use the Internet to find maternity-related information and to purchase maternity clothes. Our websites are therefore important tools for educating existing and potential customers about our brands and driving traffic to our stores. In addition to providing links to all of our websites, our DestinationMaternity.com and MaternityMall.com websites contain maternity advice and information, related baby product information and editorial content. Our marketing and technology capabilities and the replenishment capabilities of our distribution center and stores enable us to incorporate Internet design, operations and fulfillment into our existing operations. Over the past several years, we have increased the sales we generate from our websites, and we look to continue to grow our Internet sales in the future.

#### **Marketing Partnerships**

We believe our customers, particularly first time mothers, are entering a new life stage that drives widespread changes in purchasing needs and behavior, thus making our maternity customer and her family a highly-valued demographic for a range of consumer products and services companies. We have been able to leverage the relationship we have with our customers to earn incremental revenues and expect to expand these revenues through marketing partnerships and our futuretrust college savings program.

We expect to continue to expand and leverage the relationship we have with our customers and earn incremental revenues through a variety of marketing partnership programs utilizing our extensive opt-in customer database and various in-store marketing initiatives, which help introduce our customers to various baby and parent-related products and services offered by leading third-party consumer products companies. Whereas our current revenues in this area have predominantly been derived from the new pre-natal portion of our customer database, we have taken steps to update and manage our entire customer database so we can actively market our full customer database to a much broader range of consumer product and services companies that market to families with children.

Through our stores and our Internet sites, we market our futuretrust® college savings program to our customers. Futuretrust is a MasterCard® based college savings program that enables members to help save for college when they link their futuretrust MasterCard to a tax advantaged 529 College Savings account. Members earn rebates on all purchases with their futuretrust MasterCard that are automatically contributed to their 529 College Savings account and can also earn additional college savings at merchants in the futuretrust Preferred Merchant Network. We have recently entered into relationships with select providers of 529 savings programs, tax preparation services, home mortgages and real estate services for our futuretrust members and, in the future, we anticipate further developing our futuretrust program into a full service financial services and information resource for our members known as the Futuretrust Family Financial Center™. We anticipate that additional potential services offered through the Futuretrust Family Financial Center may include online banking, life insurance, and other financial services needed by families with children. We plan to offer such services through relationships with high-quality third-party providers of these services.

## Operations

**Brand-Specific Operations Teams.** To obtain maximum efficiencies, we are organized primarily along functional lines, such as merchandising, store operations, design and production. Since our business consists of five merchandise brands requiring decisions on a brand-specific basis, we have built business teams by brand where the functional leaders within each brand work together. Each brand team is led by the head merchant and includes the director of stores for that brand, the head designer, the head planner and distributor and the key production manager. These teams also include visual, fabric purchasing and other necessary professionals.

**Store Operations.** The typical maternity customer, especially the first-time mother, seeks more advice and assistance than the typical non-maternity customer. Therefore, we aim to employ skilled and motivated store team members who are trained to provide the high level of service and reassurance needed by our customers. We attempt to provide a boutique level of attentive service that differentiates us from our competitors. Our centralized merchandising and store operations also enable our store team members to focus primarily on selling and maintaining the appearance of the stores. In addition, visual merchants coordinate with the merchandising department to develop floor-sets, design store display windows and define and enhance the product presentation.

At Motherhood and Mimi, the management reporting chain consists of regional managers, district managers and store managers. At Pea, due to its smaller number of stores, the district managers report to the director of stores. Our store, district and regional managers are eligible to receive incentive-based compensation related to store, district and regional-level performance.

## Merchandising, Design and Inventory Planning and Allocation

**Merchandising.** We strive to maintain an appropriate balance between new merchandise and proven styles, as well as between basic and fashion items. Our merchandising decisions are based on current fashion trends, as well as input from our designers and outside vendors. This information is used in conjunction with the item-specific sales data provided by our proprietary merchandising and replenishment system. Each brand has its own team of merchants, designers and planners. These teams are led by the head merchant of the brand.

**Design.** Our design department creates and produces samples and patterns for our contract-manufactured products under the guidance of the merchandising department. This capability differentiates us from many of our competitors, who source their products from a limited number of maternity wear vendors. The design of our products begins with a review of European and New York runway trends, current non-maternity retail trends, fashion reporting service slides and fabric samples. The designers review our best selling items from prior seasons and integrate current fashion ideas from the non-maternity apparel business.

**Inventory Planning and Allocation.** Our planning and allocation department is responsible for planning future inventory purchases and markdowns, as well as targeting overall inventory levels and turnover. We establish target inventories for each store using our inventory planning system with the goals of optimizing our merchandise assortment and turnover, maintaining adequate depth of merchandise by style and managing closeout and end-of-season merchandise consolidation. Our proprietary capabilities enable us to continually monitor and respond quickly to consumer demand and are integral to our inventory management program. These capabilities are facilitated by our TrendTrack system, which provides daily product sell-through data and merchandising information.



## Production and Distribution

We design and contract for the production of approximately 90% of the merchandise we sell using sewing factories located throughout the world, predominantly outside of the U.S., and we continue to seek additional contractors for our sourcing needs. No individual contractor represents a material portion of our sewing. A majority of our merchandise is purchased “full package” as finished product made to our specifications, typically utilizing our designs. Fabric, trim and other supplies are obtained from a variety of sources. As we have expanded our stores and increased volumes over the past several years, we have generally been able to reduce our product costs.

Our production and quality assurance personnel monitor production at contractor facilities in the U.S. and work with our agents abroad to ensure quality control, compliance with our design specifications and timely delivery of finished goods. This quality control effort is enhanced by our worldwide Internet-based contracting and logistics systems, which include advanced features such as measurement specifications and digital photography. We also use a third-party consulting firm to help monitor working conditions at our contractors’ facilities on a worldwide basis.

We operate our primary distribution center in Philadelphia, Pennsylvania and a distribution center in Mississauga, Ontario to support our stores in Canada. We also lease a facility located in the Philadelphia Naval Business Center in Philadelphia, Pennsylvania, which we use for warehousing, distribution and raw material cutting.

Finished garments from contractors and other manufacturers are received at our primary distribution center in Philadelphia, Pennsylvania and our Canadian distribution center. Garments are inspected using statistical sampling methods and stored for picking. Our primary distribution center utilizes sophisticated fulfillment technology to serve as a replenishment center, as opposed to solely a distribution center. This distribution center sends a selection that meets individual retail location needs from our approximately 17,000 SKUs to our retail locations two to six times per week. Retail location replenishment decisions are made automatically based upon target inventories established by the allocation department and individual retail location sales data. Our primary distribution center uses several automated systems, including our pick-to-light system for flat-packed goods and our hanging garment sortation system, which speed up deliveries to our retail locations and reduce costs.

Shipments to retail locations are tracked by our proprietary delivery tracking software. Freight is routed through zone-skipping, over-the-road carriers running 24 hours per day and delivered locally by a variety of carriers, and is supplemented by a small percentage of second-day air, providing one to three-day delivery to our retail locations.

In November 2003, we were certified to participate in Customs-Trade Partnership Against Terrorism, or C-TPAT, a U.S. Department of Homeland Security sponsored program, with U.S. Customs and Border Protection (“U.S. Customs”), through which we implement and monitor our procedures to manage the security of our supply chain as part of the effort to protect the U.S. against potential acts of terrorism. Also, in January 2005, we were certified to participate in the Importer Self Assessment Program, or ISA, a U.S. Customs program available only to C-TPAT participants with strong internal controls and oversight mechanisms, through which we have assumed responsibility for monitoring our own compliance with applicable U.S. Customs regulations in exchange for certain benefits, which may help increase efficiency in importing. These benefits include exemption from government audits, increased speed of cargo release from U.S. Customs, enhanced prior disclosure rights from U.S. Customs in the event of alleged trade violations, availability of voluntary additional compliance guidance from U.S. Customs, and less intrusive government oversight of trade compliance.

## Management Information and Control Systems

We believe that our proprietary systems are instrumental to our ability to offer the broadest assortment of maternity merchandise and accomplish rapid replenishment of inventory. We continuously develop, maintain and upgrade our systems and currently employ an in-house team of programmers. Our stores have point-of-sale terminals that provide information used in our customized TrendTrack merchandise analysis and planning system. This system provides daily financial and merchandising information that is integral to monitoring trends and making merchandising decisions. The TrendTrack system has numerous features designed to integrate our retail operations with our design, manufacturing and financial functions. These features include custom merchandise profiles for each store, rapid inventory replenishment, item-tracking providing daily updated selling information for every style, classification open-to-buy and inventory control, as well as the daily collection of customer payment data, including cash, check and credit card sales data.

As part of our proprietary enterprise resource planning (ERP) system, we employ a comprehensive materials requirement planning (MRP) system to manage our production inventories, documentation, work orders and scheduling. This system provides a perpetual inventory of raw materials, actual job costing, scheduling and bill of materials capabilities. The foundation of our ERP system is a perpetual inventory of finished goods by location across all of our retail locations, which interfaces directly with our distribution facility.

In fiscal 2003, we rolled out a proprietary, upgraded point-of-sale system to our stores and integrated this system with our existing systems. This Internet-based system provides real-time access to financial and merchandising information in addition to rapid credit authorization. This upgraded point-of-sale system has significantly reduced the amount of training required for new sales associates and store managers. In addition, we plan to continue to add new features and functionality to the system, and anticipate that the system will improve our customer relationship management capabilities by enhancing our ability to create customized promotional and marketing strategies.

Given the importance of our management information systems, we have taken extensive measures to ensure their responsiveness and security. Our hardware and communications systems are based on a redundant and multiprocessing architecture, which allows their continued operation on a parallel system in the event that there is a disruption within the primary system. Our main computer system, located in our Philadelphia facility, is duplicated by a fully mirrored system in a separate part of the building with a separate power source that is designed to assume full operations should disruption in the primary system occur. In addition, our software programs and data are backed up and stored off-site. Our communications links come from two telephone frame rooms and are delivered through underground and aboveground feeds.

## Pricing

Each of our merchandise brands targets customers at different price points of the maternity apparel industry. Our Motherhood brand is positioned primarily on everyday low prices, while Mimi employs middle level pricing and Pea employs luxury pricing. None of our stores rely on point-of-sale high/low promotional strategies to drive traffic into the stores. Our price reductions are done at the individual style level and are used to accelerate the sale of slower selling merchandise. Generally, merchandise that is selling slowly is quickly marked down or moved to another store where the item is selling faster. For our leased department relationships, we consider a number of factors in determining pricing, including the target customer base, and we may use alternative pricing strategies to promote sales. The pricing of our Oh Baby! by Motherhood merchandise is determined by Kohl's pursuant to the terms of our exclusive product and licensing relationship.

## Advertising and Marketing

We believe that the power of our merchandise brands, customer referrals and our convenient mall locations drive traffic into our stores. Therefore, we have modest advertising and marketing expenditures. Our advertising and publicity efforts include in-store marketing, prenatal consumer-targeted advertising and our Internet websites. For our Destination Maternity superstores, we advertise locally prior to the grand opening, as well as some ongoing advertising in the local market thereafter. We also run full-page ads for all of our three principal merchandise brands in pregnancy-targeted publications, as well as prenatal issues of leading baby and parenting magazines, including *American Baby*, *Pregnancy*, *ePregnancy*, *Healthy Pregnancy* and *Shape Fit Pregnancy*. *A Pea in the Pod*, *Mimi* and *Motherhood* are also advertised in fashion and broad-reach magazines, such as *Vogue*, *In Style*, *Lucky*, *People* and *Glamour*. We also utilize our publicity efforts to generate free editorial coverage in broadcast television, magazines, radio and selected newspapers for all of our brands.

## Competition

Our business is highly competitive and characterized by low barriers to entry. The following are several important factors to competing successfully in the retail apparel industry: breadth of selection in sizes; colors and styles of merchandise; product procurement and pricing; ability to anticipate fashion trends and customer preferences; inventory control; reputation; quality of merchandise; store design and location; visual presentation and advertising; and customer service. We face competition in our maternity apparel lines from various sources, including department stores, specialty retail chains, discount stores, independent retail stores and catalog and Internet-based retailers, from both new and existing competitors. Many of our competitors are larger and have substantially greater financial and other resources than us. Our mid- and luxury-priced merchandise faces a highly fragmented competitive landscape that includes locally based, single unit retailers, as well as a handful of multi-unit maternity operations, none of which we believe has more than 20 stores nationwide. In the value-priced maternity apparel business, we currently face competition on a nationwide basis from retailers such as Gap®, JC Penney®, Kmart®, Old Navy®, Target® and Wal-Mart®. Several of these competitors, including Gap and Old Navy, also sell maternity apparel on their websites. We believe there has been increased competition in the maternity apparel industry, from both new and existing competitors. For example, the maternity apparel industry experienced oversupply conditions in fiscal 2004 and 2005, which resulted in a greater level of industry-wide markdowns and markdowns recognized by us on sales from our retail locations. However, we believe the oversupply conditions that have affected the maternity apparel business over our 2004 and 2005 fiscal years have eased.

## Employees

As of September 30, 2006, we had 2,520 full-time and 2,467 part-time employees. None of our employees are covered by a collective bargaining agreement. We consider our employee relations to be good.

## Executive Officers of the Company

The following table sets forth the name, age and position of each of our executive officers:

Name	Age	Position
Dan W. Matthias	63	Chairman of the Board and Chief Executive Officer
Rebecca C. Matthias	53	President, Chief Operating Officer and Director
Edward M. Krell	44	Executive Vice President—Chief Financial Officer
David Mangini	62	Executive Vice President—General Merchandise Manager

*Dan W. Matthias* co-founded Mothers Work in 1982 (along with Rebecca C. Matthias) and has served as Chairman of the Board since our inception. From 1983 to 1993, Mr. Matthias served as our Executive Vice President, and since January 1993, Mr. Matthias has been our Chief Executive Officer. Prior to Mothers Work, Mr. Matthias had been involved in the computer and electronics industry, serving as a director of Zilog, Inc. and as the President of a division of a subsidiary of Exxon Corporation.

*Rebecca C. Matthias* co-founded Mothers Work in 1982 (along with Dan W. Matthias) and has served as a director and our President since our inception. Since January 1993, Ms. Matthias has also served as our Chief Operating Officer. In 1992, Ms. Matthias was chosen as “Regional Entrepreneur of the Year” by *Inc.* magazine and Merrill Lynch Corporation, and in September 2003, Ms. Matthias was recognized as a top woman entrepreneur by the United States Small Business Administration. Prior to 1982, Ms. Matthias was a construction engineer for the Gilbane Building Company. Ms. Matthias also serves as a director on the Board of Directors of CSS Industries, Inc.

*Edward M. Krell* has served as Executive Vice President—Chief Financial Officer since November 2003, having served as Senior Vice President—Chief Financial Officer from the time he joined Mothers Work in January 2002 until November 2003. Prior to joining Mothers Work, Mr. Krell served as Executive Vice President and Chief Financial Officer of Mammoth Sports Group, Inc., an Internet and catalog retailer of golf equipment and accessories, from December 1999 to July 2000 and as an independent financial consultant from July 2000 to January 2002. From 1995 to 1999, Mr. Krell served as Executive Vice President and Chief Financial Officer of London Fog Industries, Inc., a wholesale and retail distributor of rainwear and outerwear. Mr. Krell began his career as an investment banker with Kidder, Peabody & Co. Incorporated.

*David Mangini* has served as Executive Vice President—General Merchandise Manager since August 2001. Prior to joining Mothers Work, Mr. Mangini served in various senior merchandising and executive management positions with retailers, including as Chief Merchandising Officer of Today’s Man, Chief Operating Officer of Gadzooks, and President and Chief Executive Officer of the Structure brand of Limited, Inc.

Our executive officers are elected annually by the Board of Directors and serve at the discretion of the Board. Other than the husband and wife relationship between Dan and Rebecca Matthias, there are no family relationships among any of our other executive officers.

#### **Trademarks**

We own trademark and service mark rights that we believe are sufficient to conduct our business as currently operated. We own several trademarks, including Mothers Work®, A Pea in the Pod®, Mimi Maternity®, Motherhood®, Motherhood Maternity®, Destination Maternity™, Edamame The Maternity Spa®, Two Hearts® Maternity, Oh Baby! by Motherhood™, Motherhood Maternity Outlet®, and MaternityMall.com®. As a result of the iMaternity acquisition, we also own the iMaternity®, Dan Howard® and iMaternity.com™ marks. Additionally, we own the marks futuretrust®, Futuretrust Family Financial Center™, Real Time Retailing®, What’s Showing is Your Style®, Motherhood: It’s Hot!™, Motherhood is Everything Good™, Motherhood Baby® and Maternity Redefined®.

#### **Seasonality**

Our business, like that of many other retailers, is seasonal. Our quarterly net sales have historically been highest in our third fiscal quarter, corresponding to the Spring selling season, followed by our first fiscal quarter, corresponding to the Fall/holiday selling season. Given the typically higher gross margin we experience in the third fiscal quarter compared to other quarters, the relatively fixed nature of most of our operating expenses and interest expense, and the historically higher sales level in the third quarter, we have typically generated a very significant percentage of our full year operating income and net income during

the third quarter. Results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Quarterly results may fluctuate materially depending upon, among other things, the timing of new store openings, net sales and profitability contributed by new stores, increases or decreases in comparable store sales, adverse weather conditions, shifts in the timing of certain holidays and promotions, changes in inventory and production levels and the timing of deliveries of inventory, and changes in our merchandise mix.

#### **Securities and Exchange Commission Filings**

Our Securities and Exchange Commission ("SEC") filings are available free of charge on our website, [www.motherswork.com](http://www.motherswork.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are posted on our website as soon as practicable after we furnish such materials to the SEC.

#### **Item 1A. Risk Factors**

*You should consider carefully all of the information set forth or incorporated by reference in this document and, in particular, the following risk factors associated with our business and forward-looking information in this document (see also "Forward-Looking Statements" included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations"). The risks described below are not the only ones we face. Additional risks not presently known to us or that we do not currently consider significant may also have an adverse effect on us. If any of the risks below actually occur, our business, results of operations, cash flows or financial condition could suffer.*

#### ***We may not be successful in expanding our business and opening new stores.***

Any future growth depends significantly on our ability to successfully establish and operate new stores (including combination stores and superstores) and our leased department and licensed relationships on a profitable basis. This expansion, if it occurs, will place increased demands on our management, operational and administrative resources. These increased demands and operating complexities could cause us to operate our business less effectively, which, in turn, could cause a deterioration in our financial performance and slow our growth. Our planned expansion will also require that we continually monitor and upgrade our management information and other systems, as well as our distribution infrastructure.

Our ability to establish and operate new stores and our leased department and licensed relationships successfully depends on many factors, including, among others, our ability to:

- identify and obtain suitable store locations, including mall locations, the availability of which is outside of our control;
- expand existing and establish new leased department and licensed relationships;
- negotiate favorable lease terms for stores, including desired tenant improvement allowances;
- negotiate favorable lease terminations for existing store locations in markets where we intend to open new combination stores or superstores;
- source sufficient levels of inventory to meet the needs of new stores and our leased department and licensed relationships;
- successfully address competition, merchandising and distribution challenges; and
- hire, train and retain a sufficient number of qualified store personnel.

There can be no assurance that we will be able to achieve our expansion goals. Even if we succeed in establishing new stores and further developing our leased department and licensed relationships, we

cannot assure you that our newly opened stores or leased department and licensed brand businesses will achieve planned revenue or profitability levels in the time periods estimated by us, or at all. If our stores or our leased department and licensed brand businesses fail to achieve or are unable to sustain acceptable revenue and profitability levels, we may incur significant costs associated with operating or closing those stores.

***Our comparable store sales and quarterly operating results have fluctuated in the past and can be expected to continue to fluctuate in the future and, as a result, the market price of our common stock may fluctuate or decline substantially.***

Our comparable store sales and quarterly results of operations have fluctuated in the past and can be expected to continue to fluctuate in the future and are affected by a variety of factors, including:

- the opening of new stores and success of our leased department and licensed relationships;
- the timing of new store openings and leased department and licensed brand business openings;
- the extent of cannibalization of sales volume of some of our existing retail locations by our new retail locations opened in the same geographic markets;
- changes in our merchandise mix;
- any repositioning of our brands;
- general economic conditions and, in particular, the retail sales environment;
- calendar shifts, including shifts of holiday or seasonal periods, or shifts in the number of weekend days occurring in a given month;
- changes in pregnancy rates;
- actions of competitors;
- the level of success and/or actions of anchor tenants where we have stores or leased department and licensed relationships;
- fashion trends; and
- weather conditions and seasonality.

If, at any time, our comparable store sales or quarterly results of operations decline or do not meet the expectations of Wall Street research analysts, the price of our common stock could decline substantially.

***Our business, financial condition and results of operations may be materially and adversely impacted at any time by a significant number of competitors.***

We operate in a highly competitive environment characterized by few barriers to entry. We compete against department stores, specialty retail chains, discount stores, independent retail stores and catalog and Internet-based retailers. Many of our competitors are larger and have substantially greater financial and other resources than us. Further, we do not typically advertise using television and radio media and thus do not reach customers through means our competitors may use. Our mid- and luxury-priced merchandise faces a highly fragmented competitive landscape that includes locally based, single unit retailers, as well as a handful of multi-unit maternity operations, none of which we believe have more than 20 stores nationwide. In the value-priced maternity apparel business, we face competition on a nationwide basis from retailers such as Gap, JC Penney, Kmart, Old Navy, Target and Wal-Mart. Several of these competitors, including Gap and Old Navy, also sell maternity apparel on their websites. Over the past few



years, there has been increased competition in the maternity apparel industry from both new and existing competition. Our business, financial condition and results of operations may be materially and adversely affected by this competition, including the potential for increased competition in the future. For example, the maternity apparel industry experienced oversupply conditions in fiscal 2004 and 2005, which resulted in a greater level of industry-wide markdowns and markdowns recognized by us on sales from our retail locations. There can be no assurance that these conditions will not occur again.

***Our relationships with third-party retailers may not be successful.***

We cannot guarantee successful results from our leased department and licensed relationships with third-party retailers such as Sears and Kohl's. Under our agreement with Kohl's, Kohl's is not obligated to purchase any maternity apparel from us and we are not obligated to sell any maternity apparel to them. Under our agreement with Sears, Sears does not make any promises or representations as to the potential amount of business we can expect from the sale of our Two Hearts Maternity collection. We do not control the pricing terms or the timing or degree of the markdowns at Kohl's. The success of our leased department and licensed brand businesses is highly dependent on the actions and decisions of the third-party retailers, which are outside of our control. The retailers could limit the merchandise carried, close stores, go out of business or terminate their agreements with us. Our failure to properly manage our leased department and licensed brand businesses (including any failure by us in timely delivering goods to any third-party retailer or any failure to respond to the actions of or changes in business conditions at third-party retailers) would have a direct impact on the profitability and continuation of these relationships.

***We require a significant amount of cash to service our indebtedness, which reduces the cash available to finance any growth and could adversely affect our financial health.***

We have a significant amount of indebtedness and we have the ability to incur substantial additional indebtedness in the future. Our ability to make required payments on our indebtedness, as well as to fund our operations and future growth, depends upon our ability to generate cash. Our success in generating cash depends upon the results of our operations, as well as upon general economic, financial, competitive and other factors beyond our control.

Additionally, our substantial indebtedness could have important consequences. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to making payments on our indebtedness, thereby reducing the availability of our cash flow to implement our growth strategy, or to fund working capital, capital expenditures and other general corporate needs;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- result in higher interest expense in the event of increases in interest rates as some of our debt is, and will continue to be, at variable rates of interest, and our available borrowings under our credit facility, to the extent borrowed in the future, would be at variable rates of interest;
- place us at a competitive disadvantage compared to our competitors that have less debt, or debt at lower interest rates;
- limit our ability to borrow additional funds;
- make it more difficult for us to open new stores or improve or expand existing stores;
- restrict our ability to pay dividends or make distributions to our stockholders;

- require us to pledge all or substantially all of our assets as collateral to secure indebtedness; and
- make it more difficult for us to pursue strategic acquisitions, alliances and partnerships.

If we are unable to meet our expenses and debt obligations, we may need to refinance all or a portion of our indebtedness before the scheduled maturity dates of such debt, sell assets or raise equity. On such maturity dates, we may need to refinance our indebtedness if our operations do not generate enough cash to pay such indebtedness in full and if we do not raise additional capital. Our ability to refinance will depend on the capital markets and our financial condition at such time. We cannot assure you that we would be able to refinance any of our indebtedness, sell assets or raise equity on commercially reasonable terms or at all, which could cause us to default on our obligations and impair our liquidity.

*We are heavily dependent on our management information systems and our ability to maintain and upgrade these systems from time to time.*

The efficient operation of our business is heavily dependent on our fully integrated, internally developed management information systems. In particular, we rely on point-of-sale terminals, which provide information to our customized TrendTrack merchandise analysis and planning system used to track sales and inventory. The TrendTrack system helps integrate our design, manufacturing, distribution and financial functions, and also provides daily financial and merchandising information. Although our software programs and data are backed up and stored off-site, our servers and computer systems are located at our headquarters in Philadelphia, Pennsylvania. As a result, our business, financial condition and results of operations could be materially and adversely affected if our servers and systems were inoperable or inaccessible.

From time to time, we improve and upgrade our management information systems. We have rolled out a proprietary, upgraded Internet-based point-of-sale system and integrated this system with our current systems. If we are unable to maintain and upgrade our systems or to integrate new and updated systems in an efficient and timely manner, our business, financial condition and results of operations could be materially and adversely affected.

*As an apparel retailer, we rely on numerous third parties in the supply chain to produce and deliver the products that we sell, and our business may be negatively impacted by disruptions in the supply chain.*

If we lose the services of one or more of our significant suppliers or one or more of them fail to meet our product needs, we may be unable to obtain replacement merchandise in a timely manner. If our existing suppliers cannot meet our increased needs and we cannot locate alternative supply sources, we may be unable to obtain sufficient quantities of the most popular items at attractive prices, which could negatively impact our sales, revenues and results of operations. We obtain apparel and other merchandise from foreign sources, both purchased directly in foreign markets and indirectly through domestic vendors with foreign sources. To the extent that any of our vendors are located overseas or rely on overseas sources for a large portion of their products, any event causing a disruption of imports, including the imposition of import restrictions, could harm our ability to source product. This disruption could materially limit the merchandise that we would have available for sale and reduce our revenues and earnings. The flow of merchandise from our vendors could also be adversely affected by financial or political instability, or war, in or affecting any of the countries in which the goods we purchase are manufactured or through which they flow. Trade restrictions in the form of tariffs or quotas, embargos and customs restrictions that are applicable to the products that we sell also could affect the import of those products and could increase the cost and reduce the supply of products available to us. Any material increase in tariff levels, or any material decrease in quota levels or available quota allocation, could negatively impact our business. Further, changes in tariffs or quotas for merchandise imported from individual foreign countries could lead us to shift our sources of supply among various countries. Any such shift we undertake in the future could result

in a disruption of our sources of supply and lead to a reduction in our revenues and earnings. Supply chain security initiatives undertaken by the U.S. government that impede the normal flow of product could also negatively impact our business. In addition, decreases in the value of the U.S. dollar against foreign currencies could increase the cost of products that we purchase from overseas vendors.

We also face a variety of other risks generally associated with relying on vendors that do business in foreign markets and import merchandise from abroad, such as:

- political instability or the threat of terrorism, in particular in countries where our vendors source merchandise;
- enhanced security measures at U.S. and foreign ports, which could delay delivery of imports;
- imposition of new or supplemental duties, taxes, and other charges on imports;
- delayed receipt or non-delivery of goods due to the failure of foreign-source suppliers to comply with applicable import regulations;
- delayed receipt or non-delivery of goods due to organized labor strikes or unexpected or significant port congestion at U.S. ports; and
- local business practice and political issues, including issues relating to compliance with domestic or international labor standards, which may result in adverse publicity.

The United States may impose new initiatives that adversely affect the trading status of countries where apparel is manufactured. These initiatives may include retaliatory duties or other trade sanctions that, if enacted, would increase the cost of products imported from countries where our vendors acquire merchandise. Any of these factors could have a material adverse effect on our business, financial condition and results of operations.

***We could be materially and adversely affected if our distribution operations were disrupted.***

To support our distribution of product throughout the U.S. and Canada, we operate our main distribution facility in Philadelphia, Pennsylvania and two significantly smaller distribution facilities, one in Philadelphia, Pennsylvania and the other, serving as our Canadian distribution facility, in Mississauga, Ontario. Finished garments from contractors and other manufacturers are inspected and stored for distribution to our stores. We do not have other distribution facilities to support our distribution needs. If our main Philadelphia distribution facility was to shut down or otherwise become inoperable or inaccessible for any reason, we could incur significantly higher costs and longer lead times associated with the distribution of our products to our stores during the time it takes to reopen or replace this facility. In light of our strategic emphasis on rapid replenishment as a competitive strength, a distribution disruption might have a disproportionately adverse effect on our operations and profitability relative to other retailers. In addition, the loss or material disruption of service from any of our shippers for any reason, whether due to freight difficulties, strikes, natural disaster or other difficulties at our principal transport providers or otherwise, could have a material adverse impact on our business, financial condition and results of operations.

***We could be materially and adversely affected if we are unable to obtain sufficient raw materials or maintain satisfactory manufacturing arrangements.***

We do not own any manufacturing facilities and therefore depend on third parties to manufacture our products. We place our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. We compete with many other companies for production facilities and raw materials. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control

standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. If we fail to maintain favorable relationships with these third parties, or if we cannot obtain an adequate supply of quality raw materials on commercially reasonable terms, it could have a material adverse impact on our business, financial condition and results of operations.

***Our stores are heavily dependent on the customer traffic generated by shopping malls.***

We depend heavily on locating our stores in prominent locations within successful shopping malls in order to generate customer traffic. We cannot control the development of new shopping malls, the availability or cost of appropriate locations within existing or new shopping malls or the success of existing or new mall stores.

The success of all of our mall stores will depend, in part, on the ability of each mall's anchor tenants, such as large department stores, other tenants and area attractions to generate consumer traffic in the vicinity of our stores, and the continuing popularity of malls as shopping destinations. Many traditional enclosed malls are experiencing lower levels of customer traffic than in the past. Sales volume and mall traffic may be adversely affected by economic downturns in a particular area, the closing of anchor tenants or competition from non-mall retailers and other malls where we do not have stores.

***Our success depends on our ability to identify and rapidly respond to fashion trends.***

The apparel industry is subject to rapidly changing fashion trends and shifting consumer demands. Accordingly, our success depends on the priority that our target customers place on fashion and our ability to anticipate, identify and capitalize upon emerging fashion trends. Our failure to anticipate, identify or react appropriately to changes in styles or trends could lead to, among other things, excess inventories and higher markdowns, as well as the decreased appeal of our brands. An inaccuracy of our forecasts regarding fashion trends could have a material adverse effect on our business, financial condition and results of operations.

***The failure to retain our existing senior management team or to attract and retain highly skilled and qualified personnel could have a material adverse impact on our business, financial condition and results of operations.***

Our business requires disciplined execution at all levels of our organization in order to timely deliver and display fashionable merchandise in appropriate quantities in our stores. This execution requires experienced and talented management. We currently have a management team with a great deal of experience with us and in apparel retailing. If we were to lose the benefit of this experience and, in particular, if we were to lose the services of Dan Matthias, our Chairman and Chief Executive Officer, or Rebecca Matthias, our President and Chief Operating Officer, our business, financial condition and results of operations could be materially and adversely affected.

In addition, as our business expands, we believe that our success will depend greatly on our continued ability to attract and retain highly skilled and qualified personnel. There is a high level of competition for personnel in the retail industry. Like most retailers, we experience significant employee turnover rates, particularly among store sales associates and managers, and our continued growth will require us to hire and train even more new personnel. We therefore must continually attract, hire and train new personnel to meet our staffing needs. We constantly compete for qualified personnel with companies in our industry and in other industries. A significant increase in the turnover rate among our sales associates and managers would increase our recruiting and training costs and could decrease our operating efficiency and productivity. If we are unable to retain our employees or attract, train, assimilate or retain other skilled personnel in the future, we may not be able to service our customers as effectively, thus impairing our ability to increase revenue and could otherwise harm our business.

***Our quarterly operating results and inventory levels may fluctuate significantly as a result of seasonality in our business.***

Our business, like that of other retailers, is seasonal. Results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Our quarterly net sales have historically been highest in our third fiscal quarter, corresponding to the Spring selling season, followed by our first fiscal quarter, corresponding to the Fall/holiday selling season. Given the typically higher gross margin we experience in our third fiscal quarter compared to other quarters, the relatively fixed nature of most of our operating expenses and interest expense, and the historically higher sales level in our third fiscal quarter, we have typically generated a very significant percentage of our full year operating income and net income during our third fiscal quarter. Thus, any factors which result in a material reduction of our sales for the third quarter could have a material adverse effect on our results of operations for our fiscal year as a whole. Seasonal fluctuations in sales also affect our inventory levels, as we usually order merchandise in advance of peak selling periods and sometimes before new fashion trends are confirmed by customer purchases. We must carry a significant amount of inventory, especially before the Fall/holiday and Spring selling seasons. If we are not successful in selling our inventory during this period, we may be forced to rely on markdowns or promotional sales to dispose of the excess inventory or we may not be able to sell the inventory at all, which could have a material adverse effect on our business, financial condition and results of operations.

***Our business depends on sustained demand for maternity clothing and is sensitive to birth rates, economic conditions and consumer spending.***

Our business depends upon sustained demand for maternity clothing. Our future performance will be subject to a number of factors beyond our control, including demographic changes. If demand for maternity clothing were to decline for any reason, such as a decrease in the number of pregnancies, our operating results could be adversely affected. Downturns, or the expectation of a downturn, in general economic conditions could adversely affect consumer spending patterns, our business, financial condition and results of operations. In addition, the specialty apparel retail business historically has been subject to cyclical variations. Consumer purchases of specialty apparel products, including maternity wear, may decline during recessionary periods and at other times when disposable income is lower. Declines in consumer spending patterns may have a more negative effect on apparel retailers than some other retailers. Therefore, we may not be able to maintain our historical rate of growth in revenues and earnings, or remain as profitable, if there is a decline in consumer spending patterns. A prolonged economic downturn could have a material adverse impact on our business and results of operations.

***If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image.***

While we maintain policies and guidelines with respect to labor practices that independent manufacturers that produce goods for us are contractually required to follow, and while we have an independent firm and Company employees inspect certain manufacturing sites to monitor compliance, we cannot control the actions of such manufacturers or the public's perceptions of them, nor can we assure that these manufacturers will conduct their businesses using ethical or legal labor practices. Apparel companies can be held jointly liable for the wrongdoings of the manufacturers of their products. While many of our independent manufacturers are routinely monitored by buying representatives, who assist us in the areas of compliance, garment quality and delivery, we do not control the manufacturers' business practices or their employees' employment conditions, and manufacturers act in their own interest which may be in a manner that results in negative public perceptions of us, and/or employee allegations against us or court determinations that we are jointly liable. Violations of law by our importers, buying agents, manufacturers or distributors could result in delays in shipments and receipt of goods and could subject us

to fines or other penalties, any of which could restrict our business activities, increase our operating expenses or cause our revenues to decline.

***Our earnings would decline if our goodwill becomes impaired.***

As a result of purchase accounting for our various acquisitions, we have accumulated \$50.4 million of goodwill as of September 30, 2006. Following our adoption of a new accounting standard on October 1, 2001, goodwill and other intangible assets with indefinite lives are not amortized, but rather tested for impairment annually. The impairment test requires us to compare the fair value of business reporting units to their carrying value, including assigned goodwill. The fair value of our single reporting unit is determined based on the fair market value of our outstanding common stock on a control basis and, if necessary, an outside independent valuation is obtained to determine the fair value. The carrying value of our single reporting unit, expressed on a per share basis, is represented by the book value per share of our outstanding common stock. The results of the annual impairment test performed as of September 30, 2006 indicated the fair value of the reporting unit exceeded its carrying value. As of September 30, 2006, our book value was \$14.35 per share of outstanding common stock and the closing trading price of our common stock was \$48.12 per share. If the per share fair value of our single reporting unit was less than the book value per share on September 30, 2006, our goodwill would likely have become impaired. If the per share fair value of our single reporting unit were to decline in the future below the then applicable book value of our outstanding common stock, our goodwill would likely have been impaired. If we determine in the future that impairment has occurred, we would be required to write off the impaired portion of goodwill, which could substantially reduce our earnings and result in a substantial decline in the price of our common stock.

***We may be unable to protect our trademarks and other intellectual property.***

We believe that our trademarks and service marks are important to our continued success and our competitive position due to their recognition with our customers. We devote substantial resources to the establishment and protection of our trademarks and service marks. Although we actively protect our intellectual property, there can be no assurance that the actions that we have taken to establish and protect our trademarks, service marks and other intellectual property, including our rights in our management information systems, will be adequate to prevent imitation of our marks, products or services by others or to prevent others from seeking to block sales of our products as a violation of their trademarks, service marks or other proprietary rights. Also, others may assert rights in, or ownership of, our trademarks and other proprietary rights and we may not be able to successfully resolve these types of conflicts. In addition, the laws of certain foreign countries may not protect our trademarks and proprietary rights to the same extent as do the laws of the U.S. We cannot assure you that these registrations will prevent imitation of our name, merchandising concept, store design or private label merchandise or the infringement of our other intellectual property rights by others. Imitation of our name, concept, store design or merchandise in a manner that projects lesser quality or carries a negative connotation of our brand image could have a material adverse effect on our business, financial condition and results of operations.

***War or acts of terrorism or the threat of either may negatively impact availability of merchandise and otherwise adversely impact our business.***

In the event of war or acts of terrorism, or if either is threatened, our ability to obtain merchandise available for sale may be negatively affected. A substantial portion of our merchandise is imported from other countries. If goods become difficult or impossible to import into the U.S., and if we cannot obtain such merchandise from other sources at similar costs, our sales and profit margins may be adversely affected. In the event that commercial transportation is curtailed or substantially delayed, our business may